

WATER/FLC:jlj

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

WATER DIVISION  
Water Branch

RESOLUTION NO. W-4525  
April 7, 2005

**RESOLUTION**

**(RES. W-4525), GREAT OAKS WATER COMPANY.  
ORDER REJECTING ADVICE LETTER NO. (AL) 165.**

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**SUMMARY**

This Resolution rejects Great Oaks Water Company's (Great Oaks' or Company's) Advice Letter Number (AL No.) 165 for the reasons shown.

**BACKGROUND**

Great Oaks filed AL No. 165, on December 13, 2004, to establish five memorandum (memo) accounts using the procedure described in the Water Division's Standard Practice U-27-W (Standard Practice or U-27-W). The U-27-W procedure requires water utilities to file in the "Preliminary Statement" part of the tariffs new tariff sheets with descriptions of the memo accounts. This is the method for establishing memo accounts used by energy and telecommunications utilities. Great Oaks requested five separate memorandum accounts as follows:

1. A **Rate Case and Regulatory Memorandum Account** to track the costs of the new Rate Case Plan and other new regulatory requirements. The Company anticipates that new Rate Case Plan compliance could increase the Company's regulatory expenses by up to \$700,000 to \$900,000 every three years. These expenses included additional outsourcing for expert regulatory, engineering, environmental, and legal assistance.
2. A **Water Pollution Memorandum Account** to track the costs of litigation when a pollution event occurs, or to track the costs of litigation to prevent pollution from occurring. Great Oaks estimates that these costs could exceed \$200,000 per event. It goes on to state that new wells and piping to replace a contaminated well could cost over \$500,000.

3. An **Earthquake Memorandum Account** to track the costs related to recovery from an earthquake.
4. A **Santa Clara Valley Water District Memorandum Account** to track litigation costs incurred to stop the Santa Clara Valley Water District from discriminating against the Company and its ratepayers in how it charges for water pumped from the ground as opposed to treated surface water, and
5. A **Terrorism and Vandalism Memorandum Account** to track the costs incurred recovering from a vandalism or terrorism attack.

On December 29, 2004, the Office of Ratepayer Advocates (ORA) filed a protest to AL No. 165. ORA noted the existence of the Catastrophic Event Memorandum Account codified in Public Utilities Code Section 454.9, and cited the provisions of Decision (D.) 02-08-054 wherein the Commission laid out four guidelines for the establishment of memo accounts:

1. The expense is caused by an event of an exceptional nature that is not under the utility's control;
2. The expense cannot have been reasonably foreseen in the utility's last General Rate Case (GRC) and will occur before the utility's next scheduled rate case;
3. The expense is of a substantial nature in the amount of money involved; and
4. The ratepayers will benefit by the memorandum account treatment adopted.<sup>1</sup>

The protest went on to quote from the dicta in D.02-06-018:<sup>2</sup>

“determining whether to create a memorandum account under these standards may well require complex factual findings and legal conclusions. The advice letter process is not well suited for such issues. The advice letter process is for ministerial actions implementing previously approved Commission policy.”

Great Oaks responded by electronic mail on December 29, 2004. It requested that ORA reconsider its position or that ORA's protest be rejected. Great Oaks argued that the AL was properly filed in accordance with the Standard Practice; it complies with the court decision that makes memorandum accounts effective on regular statutory notice if not suspended,<sup>3</sup> the old method of sending a letter to the Director of the Water Division requesting a resolution establishing a memorandum account takes more time and effort; the procedure used provided

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<sup>1</sup> D.02-08-054, August 22, 2002, “Interim Decision Authorizing the Creation of a Memorandum Account,” in Application 01-09-062 et seq. *In the Matter of the Application of California Water Service Company (U 60 W), a Corporation, for an Order Authorizing It to Increase Rates Charged for Water Service at Each of Its Operating Districts to Recover Increased Operating Expenditures at Its General Office*, at 3.

<sup>2</sup> D.04-06.018, June 9, 2004, “Interim Order Adopting Rate Case Plan,” in I.03-09-005, *Order Instituting Rulemaking on the Commission's Own Motion to Evaluate Existing Practices and Policies for Processing General Rate Cases and to Revise the General Rate Case Plan for Class A Water Companies*, at 26.

<sup>3</sup> *Southern California Edison Company v. PUC*, 85 Cal. App. 4<sup>th</sup> 1086, 102 Cal. Rptr. 684 (Dec 2000).

clear notice of the intent of the utility and the expenses that can be tracked in the memorandum account to both ORA and Great Oaks' customers; that establishing a memorandum account does not prejudice recovery; and only extraordinary expenses will be tracked in these accounts.

Great Oaks then attempted to justify each account:

The **Rate Case and Regulatory Memorandum Account** is required because in its last rate case Great Oaks did not recover \$200,000 in unanticipated regulatory expense costs. This was due to ORA prevailing on the issue that Great Oaks should be limited to the estimate of regulatory costs it made in its filing. The purpose of this account is to protect against retroactive ratemaking when Great Oaks requests recovery of its regulatory expense in the future.

The **Water Pollution Memorandum Account** allows the utility to respond quickly to chemical spills. Great Oaks' aquifer does not have a protective clay layer over it, and chemicals can percolate into the groundwater rapidly. This account would allow expeditious response to these incidents.

The **Earthquake Memorandum Account** would allow Great Oaks, which is almost astride the San Andreas Fault and does not have any earthquake insurance, to respond to earthquake-induced problems. The company believes that the approval of this account would also respond to inquiries from customers and provide reassurance "to those who ask what we have in our tariffs."

The **Santa Clara Valley Water District Memorandum Account** would allow the company to sue the Santa Clara Valley Water District for reevaluation of cost allocations between surface water and groundwater customers. Great Oaks believes the District discriminates against groundwater customers when it sets its fees.

The **Terrorism and Vandalism Memorandum account** would respond to customer concerns about the utility's ability to respond to terrorist attacks.

## **DISCUSSION**

ORA's protest drew attention to four guidelines the Commission has promulgated as to what expenses deserves memorandum account protection. We reiterate them by repeating the language from Standard Practice U-27-W below (footnotes in original):

"8. A **memorandum (memo) account** accrues expenses and the carrying cost and depreciation on capital investments, and offsetting revenues such as insurance proceeds, when authorized by the Commission. Memo accounts track costs and revenues as reserve accounts do, but recovery of these costs is not guaranteed, as it is for reserve accounts (after reasonableness review and a means test). Example memo account expenses include legal fees, watershed study costs, Department of Health Services (DHS) costs (except penalties) and other events of an exceptional nature that are not under the utility's control, could not have been reasonably

foreseen in the utility's last general rate case, that will occur before the utility's next scheduled rate case<sup>4</sup>, are of a substantial nature in that the amount of money involved is worth the effort of processing a memorandum account and that have ratepayer benefits<sup>5</sup>. A memorandum account is not recorded in the utility's accounting books; it represents off-book accounting records. New memorandum accounts may be requested by advice letter requesting approval of a change to the preliminary statement to include a description of the memorandum account. Advice letter memorandum account recoveries require an earnings test and proof of reasonableness."

In its filing, Great Oaks did not discuss its proposed memo accounts with respect to these guidelines. It did not explain why the expense would be exceptional, why it could not have been foreseen in the last GRC, how substantial the costs would be (although Great Oaks noted that its last recorded Regulatory Expense exceeded its authorized amount by \$200,000) or, for the first, third, and fifth accounts, how ratepayers would benefit.

Additionally, Great Oaks is due to file a GRC in July of 2005. As we have stated in the past, the GRC is a much more appropriate forum to consider, and potentially authorize, memorandum accounts.

With respect to the Rate Case and Regulatory Memorandum Account: while in its last GRC the utility may have underestimated its regulatory expense, we anticipate that that should not happen in the future. Since this expense is based on the dollars expended in the GRC, there is no need for this account.

With respect to the Water Pollution Memorandum Account: Great Oaks has prior exposure to pollution events. In its response to the protest, Great Oaks expounded on its experience with the first Superfund site in the United States (Fairchild Camera, IBM, et. al.). With this kind of familiarity it should be possible for Great Oaks to decide, when the event occurs, whether a memorandum account is called for. In the instance cited above, it did not request a memorandum account. In fact, the utility sued and was awarded damages in excess of its costs to remediate the contamination. ORA negotiated a 50-50 split of the damages between the utility and the ratepayers<sup>6</sup>. Clearly, having a memorandum account could reduce the utility's incentive to litigate, both because in the absence of litigation the cleanup costs could be booked to the memorandum account and be recovered from ratepayers and because with a memorandum account the entire recovered revenues, including damages, might be credited to ratepayers. In any case, these possibilities are more properly discussed in the GRC.

The Earthquake Memorandum Account tracks the cost of recovering from an earthquake. However, the Catastrophic Event Memorandum Account codified in Section 454.9 of the Public

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<sup>4</sup> For these first three requirements see Decision 94-06-033, June 22, 1994, at 51.

<sup>5</sup> For example, a memorandum account to book legal costs to fight a takeover by a potentially incompetent entity might have ratepayer benefits, but a memorandum account to book legal costs to fight a takeover by a competent water district would not.

<sup>6</sup> Decision 93-09-077, September 17, 1993.

Utilities Codes was in response to the 1989 Loma Prieta earthquake. Clearly this account duplicates the Catastrophic Event Memorandum Account and is unnecessary.

The Santa Clara Valley Water District Memorandum Account seems to be a litigation memorandum account. The pursuit of this litigation would hopefully result in a readjustment by the Santa Clara Valley Water District (District) in how it covers its costs, shifting more costs to surface water customers and lowering the costs to Great Oaks and other groundwater customers. Great Oaks estimates savings of as much as \$2,500,000. While this may be a worthy endeavor, it needs to be discussed in the GRC. If there are going to be cost savings, this Commission should decide how they should be allocated. Also, lowering Great Oaks' cost might result in raising other utility's costs. For example, San Jose Water Company's customers' costs may increase since San Jose buys treated surface water from the District. Consideration of these and any other consequences is best addressed in a GRC.

The Terrorism and Vandalism Memorandum Account differs from the Security Cost Memorandum Account that we denied for California-American Water Company in D.03-10-070, on October 30, 2003. That request was to make its facilities more secure. We denied the relief requested because the issue was not critical and should be addressed in a GRC. This account, on the other hand, is to restore and repair facilities in the event of a terrorist attack or vandalism. Without clearer justification, this request is hard to evaluate, but we suspect it would fail the test of substantial cost as well as whether there is a viable threat that either a terrorist attack or vandalism will occur prior to the next GRC. Also, if the event was serious enough to trigger a gubernatorial or federal classification as a disaster, the Catastrophic Event Memorandum Account may apply. Again, the proper place to address terrorism and vandalism issues is in the GRC.

### **NOTICE AND PROTESTS**

Because the AL requested no rate changes, no public notice was required. The AL was sent to the standard service list. The Office of Ratepayer Advocates protested on December 29, 2004. Great Oaks replied by electronic mail on December 29, 2004.

### **COMMENTS**

Per statutory requirement, a draft of this resolution was mailed to parties for comments at least 30 days prior to consideration by the Commission.

Public Utilities Code Section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

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The 30-day comment period for the draft of this resolution was neither waived or reduced. Accordingly, the draft resolution was mailed to parties for comments on February 18, 2005, with comments due on March 21, 2005.

**FINDINGS**

1. The Commission has promulgated four guidelines for the establishment of memorandum accounts during the General Rate Case cycle.
2. Great Oaks did not justify its proposed memo accounts using these guidelines.
3. Great Oaks is scheduled to file a General Rate Case in July of 2005,
4. The Rate Case and Regulatory Memorandum Account is unnecessary.
5. The Water Pollution Memorandum Account is premature.
6. The Earthquake Memorandum Account is duplicative.
7. The Santa Clara Valley Water District Memorandum Account and the Terrorism and Vandalism Memorandum Account should be addressed in Great Oak's next GRC.

**THEREFORE IT IS ORDERED THAT:**

1. Great Oaks Water Company's Advice Letter No. 165-W is denied.
2. This resolution is effective today.

I hereby certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on April 7, 2005; the following Commissioners approved it:

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STEVE LARSON  
Executive Director